In The

Supreme Court of the United States

October Term, 1977

No. 77-1726

IN RE:

VODCO VOLUME DEVELOPMENT COMPANY, INC.,
Bankrupt.

HERMAN APPLEMAN,
Appellant,

vs.

ERICK FUREDY, Trustee,
Appellee.

On Appeal from the United States Court of Appeals For the Tenth Circuit

JURISDICTIONAL STATEMENT

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On Appeal from the United States Court of Appeals For the Tenth Circuit

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JURISDICTIONAL STATEMENT

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Appellant appeals from the judgment, entered on December 29, 1977, and from the denial of a Petition for Rehearing entered on February 8, 1978, by the United States Court of Appeals for the Tenth Circuit. The judgment entered December 29, 1977 reversed an order of the United States District Court for the District of Colorado, which in turn reversed an order of the Bankruptcy Judge of said District Court. Appellant submits this Statement to show that the Supreme Court of the United States has jurisdiction of the appeal and that a substantial question is presented.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit is reported at 567 F. 2d 967. Neither the opinion of the United States District Court nor that of the Bankruptcy Judge is reported. Copies of the written opinion of the Court of Appeals, the written order and transcript of the oral ruling of the District Court, and the written memorandum opinion and order of the Bankruptcy Judge are attached hereto as Appendices A1-A5, App. pp. A1-A33.

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JURISDICTION

This action was commenced by Erick Furedy, Trustee, Appellee herein, under Section 60 of the Bankruptcy Act, 11 U. S. C. § 96, seeking to avoid certain transactions between Appellant and the Bankrupt on the grounds that these transactions constituted preferential transfers.

The judgment of the United States Court of Appeals for the Tenth Circuit was entered December 29, 1977. (See Appendix A1, App. pp. A1-A10). An order denying Appellant's Petition for Rehearing was entered February 8, 1978. (See Appendix B, App. p. A34.) Notice of Appeal to the Supreme Court was filed in the United States Court of Appeals for the Tenth Circuit on March 14, 1978. (See Appendix C, App. pp. A35-A36.)

The jurisdiction of the Supreme Court to review this decision on appeal is conferred by 28 U. S. C. § 1254(2) and 11 U. S. C. § 47(c).

The following decisions sustain the jurisdiction of the Supreme Court to review this decision on appeal: *Watson v. Employers Liability Assurance Corp., Ltd.*, 348 U. S. 66 (1954); *New York v. Latrobe*, 279 U. S. 421 (1929); and *Dutton v. Evans*, 400 U. S. 74 (1970).

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STATUTES INVOLVED

The state statute invalidated by the decision of the United States Court of Appeals for the Tenth Circuit is Section 4-9-403(3), C. R. S. 1973, found in Volume 2, pp. 528-29 of the Colorado Revised Statutes, 1973. The full text of this statute is set forth in Appendix D, App. pp. A37-A40 hereto. (This statute was amended by the Colorado Legislature June 5, 1977, effective January 1, 1978. The effective date of the amendment was subsequent to both the dates of the pertinent transactions herein and the opinion of the United States Court of Appeals for the Tenth Circuit sought to be reviewed on this appeal. The amended statute is found in Volume 1, pp. 332-33 of the 1977 Session Laws of Colorado.)

Section 60 of the Bankruptcy Act, 11 U. S. C. § 96, is set forth in Appendix E, App. pp. A41-A44 hereto.

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QUESTIONS PRESENTED

1. When the time of transfer of a debtor's property for purposes of defining a preference which is potentially voidable under the Bankruptcy Act is the time when "it became so far perfected that no subsequent lien upon

such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee," does state law determine whether a security interest is so far perfected that no such lien could become superior, or does state law determine only the procedure for perfection and federal law determine whether a lien creditor could become superior?

2. When the time of transfer of a debtor's property for purposes of defining a voidable preference under the Bankruptcy Act is the time at which "it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee," and state law regarding perfection of a security interest provides that the security interest is continuously so perfected except as to persons who have *actually* acquired rights during a specified period, may a trustee in bankruptcy hypothecate a lien during the specified period, thereby invalidating the *actual* creditor requirement of state law, to establish a later transfer and thereby establish a preference?

STATEMENT OF THE CASE

On June 24, 1974 Appellant Herman Appleman (hereinafter referred to as "Appleman") loaned $15,000 to the debtor, Vodco Volume Development Company, Inc., and accepted as collateral accounts receivable by way of a security agreement dated the same day. Appleman duly filed with the Colorado Secretary of State a financing statement disclosing his security interest. This statement contained a stated maturity date of September 25, 1974. On December 26, 1974 the debtor made a partial payment of $5,000 on the obligation. On February 24, 1975 Appleman filed a continuation statement with the Colorado Secretary of State. On or about March 21, 1975 Appleman collected certain of the debtor's accounts receivable, applying the proceeds to the loan balance. A voluntary petition in bankruptcy was filed by the debtor on April 10, 1975.

Appellee Erick Furedy, the Trustee in the bankruptcy action, brought suit against Appleman to avoid the transactions of December 26, 1974, February 24, 1975 and March 21, 1975, alleging that these transactions constituted preferential transfers under Section 60 of the Bankruptcy Act, 11 U.S.C. § 96. At the trial of this matter no evidence was introduced showing the existence of any creditor who obtained a lien upon, or otherwise acquired rights in, the collateral between November 24, 1974 and February 24, 1975. After trial the Bankruptcy Judge, in an opinion filed February 19, 1976, ruled that the transfers occurred within four months of bankruptcy and otherwise met the definition of voidable preferences.

On appeal by Appleman, the United States District Court for the District of Colorado reversed the ruling of the Bankruptcy Judge. In its oral ruling on May 20, 1976 the District Court held that under Colorado's unique version of the Uniform Commercial Code Appleman's security interest was continuously perfected by virtue of his filing the continuation statement in February, 1975, and that the transfers were thus deemed to have occurred outside the four-month period. Since the Colorado statute permitted subordination of the security interest only to persons who

actually acquired rights in the collateral between the last effective date of the financing statement and the filing of the continuation statement, and no evidence was offered that such an actual creditor existed during that period, the District Court held that the interest had continuously remained so far perfected that no lien creditor could defeat it.

On appeal by the Trustee, the United States Court of Appeals for the Tenth Circuit reversed the District Court's ruling, invalidating the requirement of actual rights under the Colorado statute, upon which Appleman and the District Court relied, and held that the Bankruptcy Act permitted a potential creditor's interest to be used to determine time of transfer.

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THE QUESTIONS ARE SUBSTANTIAL

The issues involved in this appeal concern the interrelationship between federal bankruptcy law and state perfection law for chattel security interests. These issues are of importance to the financing industry and to any creditor who claims a security interest in personal property and relies upon state law to determine the status of the security interest vis-a-vis other creditors and a trustee in bankruptcy. The holding of the Tenth Circuit Court of Appeals relegates state law concerning perfection of security interest to a question of procedure only, and requires that federal law be used to determine the effect of perfection, once perfection has been procedurally accomplished under state law. Federal law, however, does not provide a method of determining the effect of perfection. Rather, the effect of perfection must be determined by state law. It is the contention of this appeal that if state law is used to determine the effect of perfection, the state perfection rules must be used in their entirety, and may not be selectively modified by the federal statute to accomplish a purpose quite unintended by the legislature of the state.

Although the statute specifically invalidated by the interpretation of the Tenth Circuit Court of Appeals has since been modified by the state legislature, the issue raised by this appeal—that is, whether the effect of perfection of a security interest under state law will be used to determine the time of transfer of property for purposes of defining a voidable preference under the Bankruptcy Act—is of substantial importance in any bankruptcy proceeding in which a trustee seeks to set aside the security interest of a secured creditor as a voidable preference.

This case involves a financing statement which, under state law, would have lapsed by reason of its stated maturity date on November 24, 1974, but the Colorado Uniform Commercial Code contained a provision in § 4-9-403 (3), C. R. S. 1973, stating:

> ". . . The failure to file a continuation statement within the time provided in this section shall not affect the validity of a secured party's security interest as against the debtor, and if a continuation statement is filed subsequent to the time provided for but in no event later than two years thereafter, then the late filing shall have the same effect as if it were filed within the time provided, except as to persons who may have acquired rights subsequent to the time when the filing should have been made and prior to the late filing, *and as to them only to the extent of the rights so acquired*. . . ." (Emphasis added.)

A continuation statement was filed on February 24, 1975, within the two year period. No evidence was introduced concerning the existence of persons who acquired rights subsequent to the time when the filing should have been made and prior to the late filing.

By way of explanation, the Colorado comment to § 4-9-403 (3) elaborated upon the purpose of the two year grace period for filing a continuation statement as follows:

> "The Colorado Legislative change to this section serves to ameliorate the harshness of this section in the official text. Without the Colorado amendment to subsection (3) the failure to timely file a continuation statement would cause a lapse in the effectiveness of the financing statement. The Colorado amendment provides that such a failure does not affect the validity of a secured party's security interest as against the debtor, and further that the filing of a continuation statement after such a failure (but not later than two years after the time provided for filing) constitutes a valid continuation statement except as to any rights acquired during the time between the date the filing should have been made and the date actually filed. As indicated in the last sentence of subsection (3) the statement does not actually lapse until expiration of the two-year period." Colorado Comment in § 4-9-403, C. R. S. 1973.

The state statute in this case provided that upon filing of a continuation statement, subsequent to the time provided but within a two-year period after the normal maturity date of the financing statement, the late filing will have the same effect as if it were filed within the time provided. Thus, perfection under state law would have been continuous in the case at issue, and unless

rights were actually acquired in an intervening period between November 24, 1974 and February 24, 1975 (the date the filing of the continuation should have been made and the date actually filed), the security interest would not be subordinate at any time to any person.

The "time of transfer" for a preference under the Bankruptcy Act is determined by § 60 (a) (2) of the Bankruptcy Act, 11 U. S. C. § 96 (a) (2) which provides:

> "For the purposes of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee . . ."

It has been previousy held that the time of transfer is determined by federal law, but state law determines the perfection of the right. *E. F. Corporation v. Smith,* 496 F. 2d 826 at 830 (10th Cir. 1974); *Owen v. McKesson Robbins Drug Co.,* 349 F. Supp. 1327 (D. C. Fla. 1972), *aff'd* 486 F. 2d 1401. In this case, however, the Circuit Court of Appeals recast these rules, interpreting the words "could become superior" to mean that the *procedure* to be followed in perfecting a security interest in the property of the bankruptcy is determined in accordance with state law, but the *time* at which "perfection" becomes effective against the trustee in bankruptcy is determined by federal law. Further, the Court stated that §§ 60a (2) and 60a (3) of the Bankruptcy Act, 11 U. S. C. §§ 96a (2) and (3) expressly requires inchoate interests or interests of so-called "hypothetical creditors" to be considered in determining the effective date of the

transfer. To the extent that that is the case, the Court holds, the state law which will only acknowldege the interests of actual creditors during a specified period cannot overcome the Bankruptcy Act requirements that potential as well as actual creditors must be considered. It should be asserted, however, that the federal time of transfer test adopts the state perfection statute as an element of determining when the transfer occurred. If the state statute perfects the security interest against lien creditors, the federal time of transfer occurs at the time of perfection under state law. *In Re Grain Merchants of Indiana, Inc.*, 287 F. Supp. 597, *aff'd* 409 F. 2d 209, *cert. den'd* 396 U. S. 827, 90 Sup. Ct. 75, 24 L. Ed. 2d 78 (1968). The Bankruptcy Act does not specify the time of transfer but merely creates a test for such a determination, and part of that test is the rule of perfection from state law. See Note, *Voidable Preferences in the Uniform Commercial Code*, 52 Cornell L. Q. 925 (1965). The Circuit Court of Appeals overlooked the fact that the state statute specifically excludes any assumed lien creditors as part of the *perfection rule*, which is then incorporated into the federal statute to determine the time of transfer. This unusual statutory perfection, to which federal law specifically defers in § 60a (2) of the Bankruptcy Act, 11 U. S. C. § 96a (2), provides that the security interest be continuously perfected against subsequent lien creditors unless they *actually* acquire rights during the stated period, and § 60a (2) of the Bankruptcy Act, 11 U. S. C. § 96a (2), should be read to say that the time of transfer (and the perfection of the security interest) occurred at the beginning of continuous perfection unless a lien creditor actually acquired rights during the period.

While the Circuit Court of Appeals is correct that the Colorado statute does not and cannot nullify the express requirements of the Bankruptcy Act, by holding that a potential lien creditor could defeat a security interest under the Colorado statute is to invalidate the effect of the statute which requires an actual creditors' interest for that purpose. If the Bankruptcy Act requires the recognition of both potential and actual creditors in interpreting the time of transfer under the state perfection rules, this objective can still be realized without invalidating the state statute. In this case, the interests of a person actually acquiring rights in the collateral would have been superior to the rights of the secured party, and if such a person actually existed, as part of the perfection rule of state law, the time of transfer would be moved forward. The rights of a potential creditor, however, could not succeed under this state perfection rule and the time of transfer is accordingly placed at the beginning of continuous perfection. It is not inconsistent with the Bankruptcy Act to say that since a security interest could be subordinated only to interests actually acquired, a lien creditor could only obtain superior rights by acquiring those rights. Therefore, if no such rights were actually acquired, a hypothetical lien creditor could not become superior. This does not nullify the express requirement that the interest of the potential creditor be considered in determining whether a given transfer is "perfected" against the trustee in bankruptcy. In this case the interests of a potential creditor fall to the interests of the secured party, and the transfer should have been held to be perfected against the trustee in bankruptcy.

The Circuit Court of Appeals holding that state law only governs the procedure for perfection, but the actual effect of perfection to determine the time of transfer must be governed by federal law, misconstrues the interrelationship between state and federal law in determining time of transfer for purposes of defining voidable preference under the Bankruptcy Act. We believe that perfection procedure and effect of perfection as defined by state law must be used to determine the circumstances under which a transfer has been "so far perfected" that a lien creditor could not become superior to it. The questions presented by this appeal are of public importance because of the uncertainty which would necessarily result for any creditor who, by complying with the procedure under state law, could never be certain whether that procedure would be effective under federal law to protect a security interest from the attack of the trustee in bankruptcy.

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CONCLUSION

For the above reasons the questions herein are so substantial as to require plenary consideration, with briefs on the merits and oral argument, for their resolution, and the Court should note probable jurisdiction.

Respectfully submitted,

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May, 1978

APPENDIX

"Appendix A-1"

PUBLISH

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

(Filed December 29, 1977)

No. 76-1642

(75-B-1262)

IN RE: VODCO VOLUME DEVELOPMENT COMPANY, INC., Bankrupt.

ERICK FUREDY, Trustee,

Plaintiff-Appellant,

vs.

HERMAN APPLEMAN,

Defendant-Appellee.

Appeal from the United States District Court
for the District of Colorado

Submitted on the Briefs.

Thomas C. Singer, II, Englewood, Colorado, for the Appellant.

John E. Moye, Head, Moye, Carver & Ray, Denver, Colorado, and Sydney H. Grossman, Grossman, Galchinsky, Silverstein, Grossman, Denver, Colorado, for Appellee.

Before LEWIS, BARRETT and DOYLE, Circuit Judges.

LEWIS, Circuit Judge.

Furedy, trustee of Vodco-Volume Development Company, Inc., (Vodco), appeals an order of the district court

for the District of Colorado reversing an order of the bankruptcy judge and holding that three transactions involving Vodco and its creditor Appleman were not preferential transfers subject to avoidance by the trustee within the meaning of section 60(a) of the Bankruptcy Act, 11 U. S. C. § 96(a). The issue presented is one of first impression and requires us to determine whether the filing of a continuation statement pursuant to section 4-9-403 (3), Colo. Rev. Stat. Ann. (1973), after a properly filed financing statement has lapsed effects a "continuous" perfection of the original security interest against a trustee in bankruptcy.

On June 24, 1974, Vodco obtained a $15,000 loan from Appleman evidenced by a promissory note and secured by a security agreement covering Vodco's accounts receivable. Appleman properly filed a financing statement with the Colorado Secretary of State disclosing his security interest. This statement contained a stated expiration date of September 25, 1974, the maturity date of the note. When Vodco was unable to repay the note on the stated maturity date, Appleman agreed to extend the time for repayment but failed to timely file a continuation statement extending the expiration date of the original financing statement. Pursuant to section 4-9-403(2), Colo. Rev. Stat. Ann. (1973), Appleman's original financing statement therefore lapsed and his security interest became unperfected 60 days after the stated expiration date of September 25, 1974, *viz.*, on November 24.

On December 26, 1974, Vodco paid Appleman $5,000 on the note and on February 24, 1975, Appleman properly filed a "late" continuation statement with the Colorado Secretary of State pursuant to section 4-9-403(3), Colo.

Rev. Stat. Ann. (1973). About March 21, 1975, Appleman also took action to recover some of Vodco's accounts receivable.

Vodco was adjudicated a bankrupt on April 10, 1975, and the trustee sought to avoid the December, February, and March transactions and to recover the proceeds from Appleman on grounds the transactions were preferential transfers within the meaning of section 60(a) of the Bankruptcy Act, 11 U. S. C. § 96(a), Appleman defended the transactions claiming under Colorado law the continuation statement filed on February 24, 1975, related back to the date of the original financing statement (June 24, 1974) and effected a "continuous" perfection of his security interest from that date. Since his security interest was continuously perfected, Appleman contended the transactions were not made for or on account of an "antecedent" debt and therefore were not preferential transfers.

The bankruptcy judge sustained the trustee's petition to avoid the transactions and ordered Appleman to return the proceeds. Appleman appealed this order and the district court reversed.

Section 60(a) of the Bankruptcy Act, 11 U. S. C. § 96 (a), provides that certain transfers of a debtor's property to or for the benefit of a creditor within four months of a bankruptcy petition constitute preferences that may be avoided by the trustee under section 60(b) if the creditor had reasonable cause to believe that the debtor was insolvent at the time the transfers were made. The parties agree the three transactions challenged by the trustee satisfy all of the requirements of sections 60(a) and 60

(b) except the requirement that the transfers have occurred within four months of the bankruptcy petition.[1]

Section 60(a) (2) provides a transfer of property "shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee." 11 U. S. C. § 96(a) (2). Although it is undisputed that the three transactions challenged by the trustee were chronologically within four months of Vodco's bankruptcy petition, Appleman seizes upon the "perfection" test of section 60(a) (2) to argue that his security interest was continuously perfected under Colorado law from June 24, 1974, and that the transfers must therefore be deemed to have been made on that date—more than four months prior to the bankruptcy petition.

In support of this contention Appleman relies under Colorado's unique addition to the Uniform Commercial Code section dealing with continuation statements. Section 4-9-403(2), Colo. Rev. Stat. Ann. (1973), provides the effectiveness of a filed financing statement, with a stated maturity date of 5 years or less, lapses and the security interest becomes unperfected 60 days after the stated maturity date. Section 4-9-403(3), Colo. Rev. Stat. Ann.

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1 Appleman separately briefs the requirements of section 60 (a) (1) that the transfers have occurred within four months of bankruptcy, for or on account of an antecedent debt, with the effect that Appleman obtained a greater percentage of his debt than other members of his class. All of these requirements are necessarily resolved, however, by a finding that the transfers occurred within four months of bankruptcy.

(1973), initially follows the Uniform Commercial Code provision allowing a continuation statement to be filed within 6 months before and 60 days after a stated maturity date in the original financing statement but adds:

> . . . The failure to file a continuation statement within the time provided in this section shall not affect the validity of a secured party's security interest as against the debtor, and if a continuation statement is filed subsequent to the time provided for but in no event later than two years thereafter, then the late filing shall have the same effect as if it were filed within the time provided, except as to persons who may have acquired rights subsequent to the time when the filing should have been made and prior to the late filing, and as to them only to the extent of the rights so acquired. . . .

Id. The reason for this addition is explained in the official comment to section 4-9-403(3):

> The Colorado legislative change to this section serves to ameliorate the harshness of this section in the official text. Without the Colorado amendment to subsection (3) the failure to timely file a continuation statement would cause a lapse in the effectiveness of the financing statement. The Colorado amendment provides that such a failure does not affect the validity of a secured party's security interest as against the debtor and further that the filing of a continuation statement after such a failure (but not later than two years after the time provided for filing) constitutes a valid continuation statement except as to any rights acquired during the time between the date the filing should have been made and the date actually filed.
>
> As indicated in the last sentence of subsection (3), the statement does not actually lapse until expiration of the two-year period . . .

Appleman concedes the continuation statement in the present case was filed more than 60 days after the expiration date stated in the original financing statement and that during the period beginning 61 days after the stated expiration date and ending with the filing of the continuation statement other creditors could have obtained priority over his security interest. Appleman vigorously argues, however, and the district court found, that section 4-9-403 (3) only gives priority to creditors who *actually* acquired rights during this interim period. Since no evidence of the existence of such actual creditors was presented before the bankruptcy judge,[2] Appleman submits that under Colorado law his security interest must be deemed to have been continuously perfected from June 24, 1974. Relying on our statement in E. F. Corp. v. Smith, 10 Cir., 496 F. 2d 826, 830, that "perfection" of a security interest for purposes of section 60 (a) (2) of the Bankruptcy Act is to be determined in accordance with state law, Appleman concludes the trustee may not claim the status of a hypothetical creditor under section 60 (a) (3) to avoid his security interest where Colorado does not recognize inchoate interests.

Although Appleman correctly states the general rule that perfection of an interest in the property of a bankrupt debtor is to be determined by state law, he has misconstrued the effect of the corollary rule that the time of transfer is to be determined by federal law. E. F. Corp.

2 The trustee notes no such evidence was presented because the bankruptcy judge ruled the existence of actual creditors was immaterial in determining the rights of the trustee in light of his status as a "hypothetical" creditor under section 60 (a) (3), 11 U. S. C. § 96 (a) (3).

v. Smith, *supra*. Under section 60 (a) (2) a transfer is deemed to have been made "at the time when it became so far perfected that no subsequent lien upon such property . . . *could* become superior to the rights of the transferee." (Emphasis added.) Thus, although the *procedure* to be followed in perfecting a security interest in the property of a bankrupt is determined in accordance with state law, the *time* at which "perfection" becomes effective against the trustee in bankruptcy is determined by federal law. In this connection it is to be remembered that sections 60 (a) (2) and 60 (a) (3) expressly require inchoate interests or interests of so-called "hypothetical creditors" to be considered in determining the *effective* date of transfer. The fact that Colorado has chosen to recognize only those interests actually acquired during the period between lapse of the original financing statement and filing of a continuation statement, assuming *arguendo* that section 4-9-403 (3) would be so interpreted by the Colorado courts,[3] does not and cannot nullify the express requirements of the Bankruptcy Act that the interests of potential as well as actual creditors be considered in determining whether a given transfer is "perfected" against the trustee in bankruptcy.

In the present case it is undisputed that general or secured creditors of Vodeo could have obtained rights superior to Appleman's during the interim period between

3 Both parties agree the effect of section 4-9-403 (3) on inchoate rights has not been determined by the Colorado courts. In light of our conclusion that the time of transfer for purposes of section 60 (a) (2) of the Bankruptcy Act is to be determined under federal law, however, we need not speculate regarding the probable interpretation of the Colorado courts.

the lapse of Appleman's original financing statement on November 24, 1974 and the filing of Appleman's continuation statement on February 24, 1975. Since section 60 (a) (3) requires us to determine the time of transfer without regard to the actual existence of such creditors, we must hold that the transfers in question did not become so far perfected that no subsequent creditor could obtain rights superior to those of the transferee until the dates they were actually made. The bankruptcy judge therefore correctly held that Appleman's original financing statement had lapsed for purposes of the bankruptcy proceedings on the dates the transfers in question were made and that they were therefore preferential transfers.

In reversing the order of the bankruptcy judge the district court accorded considerable deference to the stated intent of the Colorado legislature to "ameliorate the harshness" of the official text of section 9-403 (3) of the Uniform Commercial Code. In doing so, however, the district court failed to consider the statutorily expressed intent of Congress that the interests of potential as well as actual creditors be considered in determining the rights of a trustee in bankruptcy and the general purpose of the Bankruptcy Act to require prompt perfection of security interests in order to provide timely and adequate notice to creditors. Our holding that the filing of a continuation statement more than 60 days after the expiration date originally stated in the financing statement does not constitute "continuous" perfection as against the trustee accommodates both the state and federal interests. The "harshness" of the uniform text is ameliorated with respect to all *state* proceedings since the agreement between the secured party and the debtor is

not rendered "void" 60 days after the stated expiration date and the interests of the creditors who were "junior" before the lapse are given priority only to the extent of new interests actually acquired during the period of lapse. At the same time the purpose of the Bankruptcy Act is satisfied by requiring a secured creditor to provide timely and adequate notice of his interest by filing a continuation statement within the statutory time period specified by section 4-9-403 (3), Colo. Rev. Stat. Ann. (1973). The fact that the Colorado statutory scheme may be "upset" by the intervention of bankruptcy is merely a necessary consequence of the exclusive congressional power to regulate bankruptcy proceedings and presents a legislative rather than a judicial problem.[4] Moreover, the Colorado legislature must have and did intend to create some distinctions between the rights of secured parties who file a continuation statement within the period initially specified in section 4-9-403 (3) and the rights of the parties filing within two years thereafter. Once it is conceded that this distinction has been drawn and the possibility created for other creditors to obtain rights superior to those of the delinquent secured party, Appleman cannot be heard to complain that the intent and purpose of the Colorado scheme is frustrated when the trustee in bank-

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4 In this connection we note that Colorado legislature could eliminate the possibility of a security interest becoming "unperfected" against the trustee in bankruptcy by following the 1972 amendment to the official text of section 9-403 (2) of the Uniform Commercial Code providing a specified effective period for *all* financing statements whether or not an expiration date is stated and requiring a continuation statement to be filed within a set period before or after the end of the specified period. Uniform Commercial Code § 9-403 (2) (1972 version) and Comments 2, 3.

ruptcy is permitted to take advantage of this distinction by congressional mandate.

The judgment of the district court is therefore reversed and the case remanded for further proceedings consistent with the opinions expressed herein.

"Appendix A-2"

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

No. 75-B-1262

IN RE VODCO-VOLUME DEVELOPMENT COMPANY, INC., Bankrupt,

HERMAN APPLEMAN,

Petitioner on Review,

vs.

ERICK FUREDY,

Respondent on Review.

ORDER

(Filed May 20, 1976)

THE BANKRUPTCY APPEAL came on for hearing on May 20, 1976 before the Honorable Sherman G. Finesilver, Judge of the United States District Court and it is

ORDERED that the Order of Bankruptcy Judge is reversed.

DATED at Denver, Colorado this 20 day of May, 1976.

BY THE COURT:

/s/ Sherman G. Finesilver, Judge
United States District Court

"Appendix A-3"

(Copy)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

75-B-1262

In re VODCO-VOLUME DEVELOPMENT COMPANY, INC., Bankrupt.

ERICK FUREDY,

Trustee-Plaintiff,

vs.

HERMAN APPLEMAN,

Defendant.

REPORTER'S TRANSCRIPT

COURT'S RULING

Proceedings before the HONORABLE SHERMAN G. FINESILVER, Judge, United States District Court for the District of Colorado, beginning at the hour of nine o'clock a. m. on the 20th day of May, 1976, in Courtroom D, United States Courthouse, Denver, Colorado.

APPEARANCES:

JOHN E. MOYE, Attorney at Law, 200 West 14th Avenue, Denver, Colorado, and SYDNEY H. GROSSMAN, Attorney at Law, 4043 Park Central, 1414 Arapahoe Street, Denver, Colorado, appearing on behalf of Appellant Appleman.

THOMAS C. SINGER, II., Attorney at Law, 1385 S. Colorado Boulevard, Number 700, Denver, Colorado, appearing on behalf of the Trustee Erick Furedy.

PROCEEDINGS:

• • •

THE COURT: I think that the points are well stated by the appellant and the trustee in this case. I would like to thank you very much. I am prepared to rule at this time, please.

The Court would initially care to commend counsel for what I think is a very articulate and assiduous presentation of a very tight legal question and while we could look to Collier for some direction, because of the uniqueness of a Colorado Uniform Commercial Code treatment of Section 9-403, 1973 CRS, we perhaps will have a result that would be unique to this factual situation and not perhaps a very persuasive or precedential in any other case. As the Court mentioned during argument of counsel, this Court is trying to harmonize if at all possible 403 with the Colorado Uniform Commercial Code with the Bankruptcy Law. I do not believe it was intended by the Bankruptcy Law to supplant or to supersede the state recording statutes that give us somewhat of a blueprint as to the validity of secured transactions. I believe in this case that an interpretation can be made that does not do violence to the Colorado statute. The Court in its ruling is somewhat persuaded by the fact that the parties in this case entered into the argeement, the creditor and the bankrupt, based on the Uniform Commercial Code. This is set forth in the original financing statement. Unequivocally, this is what they had in mind. I am very satisfied that the ruling of Bankruptcy Judge was erroneous and we reverse. I will give you the benefit of our thinking.

The matter is before the Court upon review of the decision entered by the Bankruptcy Judge on February

19th, 1976. The following Findings of Fact made by the Bankruptcy Judge, I believe, are uncontested. Counsel would agree that on June 24th, 1974, the creditor loaned $15,000.00 to the debtor. The collateral was accounts receivable and a financing statement was filed with a maturity date of September 25, 1974. On December 26th, 1974, the debtor paid $5,000.00 on the note. On February 24, 1975, the creditor filed a continuation statement under Colorado law covering the lapsed financing statement. By April 10, 1975, the debtor was adjudicated bankrupt.

We do note that the creditor here did collect modest amounts of accounts receivable, I believe, in March of 1975. We also recognize that the Bankruptcy Judge entered his order that the payment of $5,000.00 by the bankrupt to the petitioner or the appellant here on December 26th, 1974, is voided as a preferential transfer. We further find that the lien created by the filing of the continuation statement on September 24th, 1975, is void to the trustee as a preferential transfer; further, that the collection of sums from the bankrupt's accounts receivable by the appellant here on or about March 21, 1975, is avoided as further preferential transfer. The Bankruptcy Judge ordered that all sums collected by the appellant be paid over to the trustee and that the security interest of the appellant be declared void as to the trustee.

We are of the view that the filing of the financing statement on June 24, 1974, served to perfect the interest of the petitioner and the accounts receivable as collateral under the Uniform Commercial Code of Colorado, pursuant to 4-9-401 of the Colorado applicable statute. We do recognize that the financing statement expired under its own terms on June 24, 1974, but under the Colorado

statement respecting continuation statements, Section 9-4-403 (3) CRS 1973, the continuation statement may be filed subsequent to the time provided for but in no event later than two years after. We construe two-year statute of limitations, if you will, and further find that by filing a continuation statement on February 25, 1975, that the appellant continued the perfection of the first financing statement except as to persons who may have required rights subsequent to the time the filing should have been made and prior to the late filing, but as to them only to the extent of the rights so acquired. The transfer occurring on June 24, 1974, having been continuously perfected from that date by the filing of the continuation statement in our view causes a transfer to occur on June 24, 1974 outside the four-month period of bankruptcy. Further, by continuously perfecting the security interest under 403 (3), the appellant did not receive a transfer for an antecedent debt.

In further analysis, we find that the trustee sought to avoid the claim of the creditor under the theory that it constituted a voidable preference pursuant to 11 United States Code Section 96 (a). The trustee further has contended very assiduously under the Colorado version of the UCC, Section 403, a continuation statement which is filed more than 60 days after maturity of the original financing statement does not have the effect of maintaining perfection through the lapsed period. Because the claim of such a late filer can be interrupted by an intervening secured creditor, that the theory of the trustee is that Appleman had only "a conditional" perfection. The trustee also concluded that such "conditional" perfection is insufficient to withstand a challenge under Section 96 (a).

As we have noted, the Bankruptcy Judge has sustained the trustee's contentions and held that the trustee's claim in fact constituted a preference. I think pivotal in our determination is Colorado's unique treatment of the Uniform Commercial Code Section 403 which allows the secured creditor to file a continuation statement beyond the 60-day grace period found in the official text of the UCC. The Colorado version of the UCC expressly states that such a late filing "shall have the same effect as if it were filed within the time provided." We find this to be significant language except to the extent that other persons actually acquiring rights during that time. We feel that this treatment negates any inchoate rights or hypothetical rights or rights of other parties that could come in, but took no action in that regard. The theory of conditional perfection which the trustee urges has validity only during the time in which the financing statement has lapsed and prior to the time a continuation statement is filed. We construe that to be the vacuum period that if anyone in effect would have come in during this vacuum period before the continuation statement was filed, a persuasive argument could be made in regard to the superiority of their rights, but no one came in during this vacuum period and we are not persuaded that hypothetically or inchoate parties or parties with inchoate interest could have come in and should eliminate the secured interest of the creditor in this case. The statute in question specifically contemplates that such perfection is transformed into complete perfection if, during that period, no intervening creditor acquired any rights and we so hold. The Colorado Code does not allow for a subsequent challenge upon the perfection of the secured creditor based on the theory that a creditor might have intervened, for it mandates that, unless a creditor actually does intervene or intrude into what we consider to be the continuous thread of perfection, the secured party will have a claim to actual perfection if he files a continuation statement within a two-year grace period.

It is our view that the intent of the Colorado Legislature should be followed here and that to no degree did Congress in the promulgation of the Bankruptcy Code seek to invalidate the entire body of law that business people and creditors rely on in regard to the determination of their respective interests. We are satisfied that a realistic approach should be considered here based upon common business practice rather than a technical application that the Bankruptcy Code supplants in all particulars the state statute. The Colorado Comment that follows 403, I believe gives us the best codification of the legislative intent. In the Colorado Legislative Comment I think we have a succinct statement, "The Colorado legislative change to this section serves to ameliorate the harshness of this section in the official text."

The Legislature recognized the commercial reality and effect of a recorded financing statement which serves as notice to the whole world of the creditor's claims. We are of the clear view that no third parties were deceived by the transaction between the creditor and the bankrupt in this case. We are not persuaded by the argument made to the Bankruptcy Court and alluded to by the Bankruptcy Judge that the creditor here had full knowledge of the precarious financial condition of the bankrupt and that there was a devious or sub rosa plan to give the creditor a priority. We were not persuaded by that argument be-

cause we are satisfied that as between the creditor and the bankrupt, the creditor followed the procedural requirement in regard to the perfection of his security interest and once the continuation statement was filed, this served not to set forth a new chain of a relationship between the parties, but dated back to the June 24th filing and thus there would be an interrupted security transaction as I believe was intended by the Colorado Legislature nor is this legal principle foreign to the law. Any subsequent filings of documents always date back to the commencement of the action. It doesn't start the new statute of limitations running generally. It dates back, if you will, to the commencement of the action. To give it any other interpretation would mean that the filing of the continuation statement would have to require an additional construction as to when the end of that two-year period would be. Would it be two years from that date of the continuation statement? This means there would be no finality in regard to security transactions. I think there has to be an end period and that end period would be two years from the filing of that initial transaction statement and that would be the ambit as far as we interpret it.

In this case, however, as we have noted in our remarks during argument, there were no intervening creditors. We recognize there were inchoate creditors. There were hypothetical creditors that the Bankruptcy Act makes reference to and if they are out in some hinterland, they should be considered as creditors, but no one during this period of time from the time of the end of the 60-day period until the creditor filed the new continuation statement did anyone take advantage of this vacuum period.

We find that to be significant even though potentially someone could have. The intent of the Legislature was in our view to preserve a claim "as if it were filed within the time provided." I think these are not ambiguous terms. I think the Court must give these expressions a clear and common sense interpretation. To uphold the trustee's claim would work an injustice to the recorded claim of the creditor without serving, in our view, any real salutary purpose but put chaos into the recording statute of the State of Colorado merely because of the intervention of bankruptcy.

We would point out that because the continuation statement was filed within the two-year period, there was no transfer for an antecedent debt since under Colorado's version of the Code, the creditor is deemed continuously perfected. Without a transfer for an antecedent debt, there can be no preference under Section 96(a) of 11 United States Code. Under the Bankruptcy Act, the date of the transfer is determined by federal law, but the status of perfection in our view is determined by state law. We feel a persuasive case, even though not entirely analogous to the fact situation, is the case of *E. F. Construction v. Smith,* 496 F. 2d 826, a Tenth Circuit case, 1974. Under that scheme, it is clear that because of the continuous perfection under Colorado law, there has been no transfer for an antecedent debt under the Bankruptcy Act as directed in 3 Collier Section 60.36-60.51.

The fact that the creditor's interest was continuously perfected under applicable state law in our view is dispositive of the issues before us. The ruling of the Bankruptcy Judge that the creditor's perfection was only conditional is reversed. We are satisfied that in all particulars that the interpretation of the applicable state law

and the interface with the federal law was clearly erroneous.

It is the Order of this Court that the Order of the Bankruptcy Judge is reversed. This shall constitute our ruling in this case. We do not intend to issue any written ruling.

Do you understand the Order?

Mr. Moye: Yes, Your Honor.

Mr. Grossman: Yes.

Mr. Singer: Yes, Your Honor.

The Court: I would like to commend counsel for their fine treatment of a very difficult question.

(Discussion off the record.)

The Court: We will be in recess for five minutes.

(This matter in recess at 10:04 a.m.)

REPORTER'S CERTIFICATE

I, E. J. CARPENTER, Certified Shorthand Reporter and Official Reporter to this Court, do hereby certify that I was present at and reported in shorthand the proceedings in the foregoing matter; that thereafter my shorthand notes were reduced to typewritten form under my supervision, comprising the foregoing official transcript; further, that the foregoing official transcript is a full and accurate record of the proceedings in this matter on the date set forth.

DATED at Denver, Colorado, this 25th day of May, 1976.

My Commission expires December 4, 1977.

/s/ E. J. Carpenter
Official Reported (Seal)

"Appendix A-4"

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLORADO
BANKRUPTCY

No. 75 B 1262

In re VODCO-VOLUME DEVELOPMENT COMPANY, INC., Bankrupt.

ERICK FUREDY,

Trustee-Plaintiff,

vs.

HERMAN APPLEMAN,

Defendant.

MEMORANDUM OPINION

(Filed February 19, 1976)

Appearances: Thomas C. Singer, II, Attorney for Trustee; John E. Moye and Sydney H. Grossman, Attorneys for Herman Appleman

This action was brought by Erick Furedy, Trustee in bankruptcy, to avoid three alleged preferential transfers made by the Bankrupt, Vodco-Volume Development Company, Inc. (Vodco), within four months of bankruptcy to its creditor, Herman Appleman.

On June 24, 1974 Vodco found itself pressed by creditors and turned to Herman Appleman who loaned it $15,000.00. The debt was evidenced by a promissory note, and the parties executed a security agreement by which Appleman was given a secur'y agreement by which Appleman was given a security interest in Vodco's accounts receivable. Appleman then filed with the Colorado Secretary of State a financing statement which stated a maturity date of September 25, 1974.

Vodco continued to struggle financially and thus was unable to meet Appleman's demands for repayment of his note. Finally on December 26, 1974, Vodco made a $5,000.00 payment on the debt. On February 24, 1975 Appleman filed a continuation statement with the Secretary of State, and on about March 21, 1975 he took action to recover a small amount of Vodco's accounts. Vodco was adjudicated a bankrupt on April 10, 1975.

Section 60a(1) of the Bankruptcy Act states:

> A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

The Trustee asserts that three such preferences were made or suffered by the bankrupt corporation in favor of Appleman: (1) the $5,000.00 cash payment on December 26, 1974; (2) the filing of the continuation statement on February 24, 1975; and (3) the collection of the accounts receivable on March 21, 1975. If the Trustee is correct in his analysis, he may avoid the preferences if, at the time of the transfer, the creditor benefited thereby had reasonable cause to believe that the debtor was insolvent. Section 60b of the Bankruptcy Act.

The creditor, Appleman, has responded that these transfers were not made for or on account of an antecedent debt within four months of bankruptcy while the debtor was insolvent, that the transfers did not enable

him to obtain a greater percentage of his debt than other creditors of the same class, and that they may not be avoided by the Trustee as Appleman did not at the time of transfer have reasonable cause to believe that the debtor was insolvent.

The first issue to be determined is whether the transfers were made within four months of bankruptcy. The creditor's financing statement, filed June 24, 1974, gave him a perfected security interest in the Bankrupt's accounts receivable. However, by its own terms, the financing statement matured on September 25, 1974. To determine the effectiveness of the financing statement in light of such a limitation one must necessarily look to Colorado law. Section 4-9-403, C. R. S. 1973, states:

> (2) A filed financing statement which states a maturity date of the obligation secured of five years or less is effective until such maturity date and thereafter for a period of sixty days. . . . Except as hereinafter provided, the effectiveness of a filed financing statement lapses on the expiration of such sixty-day period after a stated maturity date. . . . Upon such lapse the security interest becomes unperfected. . . .
>
> (3) A continuation statement may be filed by the secured party within six months before and sixty days after a stated maturity date. . . . The failure to file a continuation statement within the time provided in this section shall not affect the validity of a secured party's security interest as against the debtor, and if a continuation statement is filed subsequent to the time provided for but in no event later than two years thereafter, then the late filing shall have the same effect as if it were filed within the time provided, except as to persons who may have acquired rights subsequent to the time when the fil-

> ing should have been made and prior to the late filing, and as to them only to the extent of the rights so acquired. . . . [T]he filing officer may, if a statement has not been continued within the two-year period, remove such lapsed statement. . . .

When the Colorado General Assembly enacted the Uniform Commercial Code it disregarded a version of Section 9-403 which provided that a financing statement which stated a maturity date ceased to be effective sixty days after that date unless a continuation statement was filed within that period of time. Had the Legislature chosen to enact that provision, Appleman's security interest would have lapsed on November 24, 1974, and any transfer after that date would clearly be a voidable preference.

However, the Colorado Legislature enacted the unique version of Section 9-403 quoted above. The reasons behind the enactment are stated in the Colorado Comment:

> The Colorado legislative change to this section serves to ameliorate the harshness of this section in the official text. Without the Colorado amendment to subsection (3) the failure to timely file a continuation statement would cause a lapse in the effectiveness of the financing statement. The Colorado amendment provides that such a failure does not affect the validity of a secured party's security interest as against the debtor and further that the filing of a continuation statement after such a failure (but not later than two years after the time provided for filing) constitutes a valid continuation statement except as to any rights acquired during the time between the date the filing should have been made and the date actually filed.
>
> As indicated in the last sentence of subsection (3), the statement does not actually lapse until expiration of the two-year period. . . .

It is Appleman's position that though he did not file his continuation statement within the sixty-day period following the maturity date, the filing within the two-year period has ". . . the same effect as if it were filed within the time provided, . . .", and thus his security interest was continuously perfected by operation of law. Appleman does admit that as a late filing creditor under the Colorado statute he would have been subject to persons acquiring rights subsequent to the sixty-day period and prior to the late filing, but since he is subject to them ". . . only to the extent of the rights so acquired. . . ." his continuous perfection cannot be interrupted by the Trustee acting as a hypothetical lien creditor only.

While the question of what constitutes perfection of a transfer is one of state law, the question of whether a transfer is preferential is covered in Section 60a of the Bankruptcy Act. 3 *Collier on Bankruptcy* (14th Ed. 1975), ¶ 60.39[2]. "The time of transfer is determined by federal law, but state law determines the perfection of the right.", *E. F. Construction v. Smith*, 496 F. 2d 826 at 830 (10th Cir. 1974). "The Bankruptcy Act itself does not specify . . . the time of transfer but merely creates a test for such a determination.", *Voidable Preferences and the Uniform Commercial Code*, 52 Cornell L. Q. 925. That test is stated in Section 60a(2) of the Bankruptcy Act:

> . . . [A] transfer of property other than real property shall be deemed to have been made or suffered *at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings* on a simple contract *could become superior to the rights of the transferee.* . . . (Emphasis added.)

In applying that test to the facts in this case, when were the transfers so far perfected that no subsequent lien on the property could become superior to the rights of the transferee? Appleman has argued that his security interest was continuously perfected under state law, so the answer must be June 24, 1974, the day when the financing statement was filed. Yet, the fallacy in that argument is that, because of its unique language, section 4-9-403(3), C. R. S. 1973, does not provide for continuous perfection, but only for *conditional* perfection. That is, unless a creditor takes an affirmative step (the filing of a continuation statement) he does not acquire the benefit of "re-perfection" granted by the statute.

Thus, after sixty days following a stated maturity date on a financing statement, a gap in security arises which can only be closed as to those persons who have not acquired rights subsequent to the expiration of the security interest and prior to the filing of the continuation statement. In the Court's opinion, any right the creditor has prior to filing of the continuation statement can only be regarded as an inchoate right which does not serve to prohibit others from acquiring interests in the secured property until the creditor takes affirmative action of his own.

In the instant case, the gap existed from November 24, 1974 until February 24, 1975. Accordingly, until Appleman filed his continuation statement, he was not a secured creditor in the sense that his rights in Vodco's accounts as security for his debt were greater than any other person. Moreover, because Appleman's security interest was only conditionally perfected after November 24, 1974, he could no longer claim that the security interest he acquired on June 24, 1974 was so far perfected that no subsequent lien could be obtained upon the Bankrupt's property superior to his rights. At least, this was so until February 24, 1975 when Appleman filed his continuation statement.

When the Colorado statute was written to permit persons other than the original secured creditor to acquire rights in the "secured" property subsequent to the sixty-day grace period, the door was opened to the Trustee in bankruptcy with his Section 60a(2) "time of transfer" test. Thus, Appleman's argument that the time of transfer was June 24, 1974 is untenable. None of the three transfers which the Trustee seeks to avoid as preferences in this case can relate back to June 24, 1974. Applying the "time of transfer" test to all three transfers, it is readily apparent that none were "so far perfected" so as to cut off the rights of others until they were actually made.

Appleman argues that, by the plain language of section 4-9-403(3) C. R. S. 1973, his security interest is subject only to " . . . persons who may have acquired rights . . . and as to them only to the extent of the rights so acquired. . . . " and that precludes the Trustee from taking the position of a hypothetical lien creditor. However, that argument does not accurately represent the position of the Trustee; he is merely asserting the Section 60a(2) "time of transfer" test, and according to Section 60a(3), "the provisions of paragraph (2) shall apply whether or not there are or were creditors who might have obtained such liens. . . . " Therefore, concludes *Collier, supra,* ¶ 60.38[2] at 952-953: ". . . there should be no need for

the trustee to show, as a condition for avoidance of the unrecorded transfer, that he in fact represents a creditor who had no notice thereof, and who thus could have obtained a lien producing superior rights."

It may be concluded that by applying the "time of transfer" test of Section 60a(2) to the circumstances of this case and the Colorado conditional perfection statute, the three transfers in this case were within four months of bankruptcy.

The next element of the voidable preference contested here, that of the transfer being for or on account of an antecedent debt, is reached more easily. It is clear that each of the transfers challenged in this case was made to repay, or "re-perfect" the security interest in, the debt of June 24, 1974. "Where the debt on account of which a transfer was made antedated the actual execution of such transfer . . . such a transfer is undeniably one for an antecedent debt. . . ." *Collier, supra,* ¶ 60.39[4] at 962. *See also: In re Morasco,* 233 F. 2d 11 (2nd Cir. 1956).

The next issue is whether Vodco was insolvent at the time that the transfer was made. One is deemed insolvent within the definition supplied by the Bankruptcy Act, Section 1(19), ". . . whenever the aggregate of his property . . . shall not at a fair valuation be sufficient in amount to pay his debts;". The testimony and financial records of the Bankrupt readily establishes its insolvency at the time of the transfers in this case. For example, consider Vodco's December 31, 1974 Statement of Financial Condition prepared by a certified public accountant. According to that document, the corporation's total assets were only $72,014.00 as contrasted with current liabilities of $92,234.00 and total liabilities of $158,825.00. At that

time Vodco had a retained earnings deficit of $106,057.00. The trial testimony was sufficient to establish that there was no significant change in conditions between December 26, 1974 and December 31 of that year, and thereafter, until bankruptcy.

The final element of the Section 60a preference challenged by the creditor is whether the effect of the transfers was to enable the creditor to obtain a greater percentage of his debt than some other creditor of the same class. Unlike the other elements of a preference, this determination is not to be made " . . . at the time the alleged preferential payment was made but by the actual effect of the payment as determined when bankruptcy results." *Palmer Clay Products Co. v. Brown,* 297 U. S. 227, 56 S. Ct. 450, 80 L. Ed. 655. In the case at hand, the actual effect of the transfers at the time of bankruptcy would be to enable Appleman to receive 100 percent of his debt; that is, not only did he receive $5,000.00 in cash, but the filing of a continuation statement made him a secured creditor to the extent of the remaining portion of his debt. And the secured creditor, where his collateral is of sufficient amount as in this case, will not be relegated to receiving the same percentage of his claim as a general creditor but will be able to realize on his security and recover the full amount of his claim. *See,* Section 65a of the Bankruptcy Act.

Did these transfers enable Appleman to receive a greater percentage of his debt than other creditors of the same class? Before that question can be answered, it must be determined within which class of creditors Appleman falls. Clearly he is not one of those creditors entitled to receive priority under Section 64 of the Bankruptcy Act. Appleman contends that he falls in the class

of secured creditors as his security interest was continuously perfected since June 24, 1974, and therefore the transfers attacked by the Trustee in this case did not enable him to receive a greater percentage of his debt than other secured creditors. However, it has already been concluded in this opinion that the Appleman security interest was not continuously perfected. Therefore, the relevant class cannot be that of the secured creditor, but must be that of the general unsecured creditor. It is apparent in this case that no one of the general unsecured creditors will receive 100 percent of his debt as these transfers would enable Appleman to do. As Appleman states in his brief: "It is admitted that if he did not remain a secured party with a valid security interest in accounts receivable throughout the pendency of this transaction, any later transfer which gave him a valid right to accounts receivable would cause him to receive a greater percentage than others of his class."

Since each of the Section 60a elements of a preference has been held to be present, it is next necessary to decide whether Section 60b applies:

> Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby . . . has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property. . . .

It was the testimony of Mr. Appleman that he had not been shown the financial statements of Vodco, that no one had told him of the troubles the corporation was facing, and that he had no reason to know of the debtor's insolvency. However, that position is untenable in light of the circumstances of the case and the other testimony.

Appleman not only made frequent visits to the company, but also saw to it that his son, Steven, was made corporate treasurer in June, 1974, and apparently the two readily communicated regarding Vodco's status. In addition, Appleman saw to it that Renee Voneuer was made bookkeeper in October, 1974, and that his accountant, Joan Reid, was employed in December, 1974 to do the tax return and year-end accounting for the company. Voneuer testified that when she was employed, Appleman told her he wanted someone he could trust to tell the truth to him about the company's financial situation and she did so, showing him financial statements, reporting that the accounts receivable figure was inflated, that the situation was worsening with accounts payable rising, that the company was $14,000.00 behind in payroll taxes, and, in December, 1974, that the company was "going under." Vodco's president, Murphy, and secretary, Lowell, testified that they kept Appleman informed as to the critical state of the company's finances and told him that repayment of his loan would probably prevent the company from paying the railroad, a creditor whose account had to be kept current if the business was to remain viable. The latter three witnesses were believable and their unanimity of opinion and lack of self-interest added to their credibility. Upon this record it is held that Appleman had reasonable cause to know of Vodco's insolvency.

Therefore, in accord with Section 60 of the Bankruptcy Act, the three transfers were preferences and may be avoided by the Trustee.

DATED: February 19, 1976

BY THE COURT:

John P. Moore
Bankruptcy Judge

"Appendix A-5"

UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF COLORADO
BANKRUPTCY

No. 75 B 1262

IN RE VODCO-VOLUME DEVELOPMENT
COMPANY, INC., BANKRUPT.

ERICK FUREDY,

Trustee-Plaintiff,

vs.

HERMAN APPLEMAN,

Defendant.

ORDER

(Filed February 20, 1976)

Upon the findings and conclusions set forth in the Court's Memorandum Opinion of February 19, 1976, it is

ORDERED, that the payment of $5,000.00 by the Bankrupt to the Defendant Herman Appleman which was made on December 26, 1974 be and the same is hereby avoided as a preferential transfer.

FURTHER ORDERED, that the lien created by the filing of a continuation statement by the Defendant Herman Appleman on February 24, 1975 be and the same is hereby declared void as to the Trustee, and that any lien created by such filing be and the same is hereby preserved for the benefit of the Bankrupt's estate.

FURTHER ORDERED, that the collection of sums from the Bankrupt's accounts receivable by the Defendant

Herman Appleman on or about March 21, 1975 be and the same is hereby avoided as a preferential transfer.

FURTHER ORDERED, that within fifteen days hereof the Defendant Herman Appleman shall account to the Trustee for any sums recovered by him from the collection of the Bankrupt's accounts receivable on or about March 21, 1975.

FURTHER ORDERED, that within fifteen days hereof the Defendant Herman Appleman shall turn over to the Trustee the sum of $5,000.00, together with any further sums collected by him from the Bankrupt's accounts receivable on or about March 21, 1975, failing in which judgment shall enter therefor and execution issue thereon upon request.

FURTHER ORDERED, that the Trustee pay to Avery Reporting Service the sum of $40.00 for the reporter's attendance fees at the hearing of November 19, 1975.

DATED: February 20, 1976

BY THE COURT:

John P. Moore
Bankruptcy Judge

"Appendix B"

JANUARY TERM—February 8, 1978

Before The Honorable David T. Lewis, Circuit Judge,
The Honorable James E. Barrett, Circuit Judge,
The Honorable William E. Doyle, Circuit Judge

No. 76-1642

IN RE: VODCO-VOLUME DEVELOPMENT COMPANY, INC., Bankrupt.

ERICK FUREDY,

Trustee-Plaintiff-Appellant,

vs.

HERMAN APPLEMAN,

Defendant-Appellee.

This matter comes on for consideration of appellee's petition for rehearing in the captioned cause.

Upon consideration whereof, the petition for rehearing is denied.

/s/ Howard K. Phillips
Clerk

A true copy
Teste

Howard K. Phillips
Clerk, U. S. Court of
Appeals, Tenth Circuit

By /s/ Linda A. Carlson, Deputy Clerk

(Seal)

"Appendix C"

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 76-1642

IN RE: VODCO VOLUME DEVELOPMENT COMPANY, INC., Bankrupt.

ERICK FUREDY, TRUSTEE,

Plaintiff-Appellant,

vs.

HERMAN APPLEMAN,

Defendant-Appellee.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

(Filed March 14, 1978)

Notice is hereby given that Herman Appleman, the Defendant-Appellee above-named, hereby appeals to the Supreme Court of the United States from the final judgment of this Court, entered December 29, 1977, reversing the judgment of the United States District Court for the District of Colorado; and from the order of this Court, entered February 8, 1978, denying Defendant-Appellee's Petition for Rehearing.

This appeal is taken pursuant to 28 U. S. C. § 1254 (2) and 11 U. S. C. § 47 (c).

Head, Moye, Carver & Ray
By: /s/ John E. Moye, # 1455, by
Sydney H. Grossman
828 Seventeenth Street
Boston Building, Suite 810
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Grossman and Grossman

By: /s/ Sydney H. Grossman, # 4391

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Attorneys for the Defendant-Appellee

"Appendix D"

UNIFORM COMMERCIAL CODE

4-9-403. *What constitutes filing—duration of filing—effect of lapsed filing—duties of filing officer.* (1) Presentation for filing of a financing statement and tender of the filing fee or acceptance of the statement by the filing officer constitutes filing under this article.

(2) A filed financing statement which states a maturity date of the obligation secured of five years or less is effective until such maturity date and thereafter for a period of sixty days. Any other filed financing statement is effective for a period of five years from the date of filing. Except as hereinafter provided, the effectiveness of a filed financing statement lapses on the expiration of such sixty-day period after a stated maturity date or on the expiration of such five-year period, as the case may be, unless a continuation statement is filed prior to the lapse. Upon such lapse the security interest becomes unperfected. A filed financing statement which states that the obligation secured is payable on demand is effective for five years from the date of filing.

(3) A continuation statement may be filed by the secured party within six months before and sixty days after a stated maturity date of five years or less, and otherwise within six months prior to the expiration of the five-year period specified in subsection (2) of this section. Any such continuation statement must be signed by the secured party, identify the original statement by file number, and state that the original statement is still effective. Upon timely filing of the continuation statement, the effectiveness of the original statement is continued for five years after the last date to which the filing was effective whereupon it lapses in the same manner as

provided in subsection (2) of this section unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the original statement. The failure to file a continuation statement within the time provided in this section shall not affect the validity of a secured party's security interest as against the debtor, and if a continuation statement is filed subsequent to the time provided for but in no event later than two years thereafter, then the late filing shall have the same effect as if it were filed within the time provided, except as to persons who may have acquired rights subsequent to the time when the filing should have been made and prior to the late filing, and as to them only to the extent of the rights so acquired. Unless a statute on disposition of public records provides otherwise, the filing officer may, if a statement has not been continued within the two-year period, remove such lapsed statement from the files and destroy it.

(4) A filing officer shall mark each statement with a consecutive file number and with the date and hour of filing and shall hold the statement for public inspection. In addition, the filing officer shall index the statement according to the name of the debtor and shall note in the index the file number and the address of the debtor given in the statement.

(5) A filing affecting fixtures shall be indexed by the clerk and recorder in the real estate records as well as in the personal property records.

Source: L. 65, p. 1468, § 1; C. R. S. 1963, § 155-9-403; L. 67, p. 51, § 1.

Cross references: **For exemption from the necessity of filing continuation statements for a perfected security interest in goods of a transmitting utility, see § 4-9-408; for disposition of lapsed financing statements by the filing officer, see § 4-9-409.**

Editor's note—Colorado legislative change: Colorado in subsection (2) added the following at the beginning of the third sentence: "Except as hereinafter provided,".

Colorado changed subsection (3) by the addition of the second to last sentence which begins with the words: "The failure to file a continuation statement . . .".

In the last sentence in subsection (3), after the word "may", Colorado deleted "remove a" and added "if a statement has not been continued within the two-year period, remove such".

Colorado did not adopt from the official text subsection (5) of this section concerning the uniform fee (compare § 4-11-102) and in 1967 added a new subsection (5) which has no counterpart in the official text.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 13 (3), 13 (4), Uniform Trust Receipts Act; Section 10, Uniform Conditional Sales Act.

Changes: Changed in substance.

Purposes of Changes:

1. Prior law was not always clear whether a mortgage filed for record gave constructive notice from the time of presentation to the filing officer or only from the time of indexing. Subsection (1) adopts the former position.

2. Prior statutes have usually limited the effectiveness of a filing to a specified period of time after which refiling is necessary. Subsection (2) follows the same policy, establishing a maximum length of five years as the filing period. If the financing statement states a maturity date of five years or less, there is added a sixty-day grace period within which the original filing may be continued without lapse. A financing statement which states that the obligation secured is payable on demand is treated as one which does not state a maturity date. The five year maximum period is substantially longer than that accorded under most prior statutes. Subsection (3) provides for the filing of one or more continuation statements (which need be signed only by the secured party) if it is desired to continue the effectiveness of the original filing.

3. Under the fourth sentence of subsection (2) the security interest becomes unperfected when filing lapses. Thereafter, the interest of the secured party is subject to

defeat by those persons who take priority over an unperfected security interest (see Section 9-301), and under Section 9-312 (5) the holder of a perfected conflicting security interest is such a person even though before lapse the conflicting interest was junior. Compare the situation arising under Section 9-103 (3) when a perfected security interest under the law of another jurisdiction is not perfected in this state within four months after the property is brought into this state.

Thus if A and B both make non-purchase money advances against the same collateral, and both perfect security interests by filing, A who files first is entitled to priority under Section 9-312 (5) (a). But if no continuation statement is filed, A's filing may lapse first. So long as B's interest remains perfected thereafter, he is entitled to priority over A's unperfected interest. This rule avoids the circular priority which arose under some prior statutes, under which A was subordinate to the debtor's trustee in bankruptcy, A retained priority over B, and B's interest was valid against the trustee in bankruptcy. In re Andrews, 172 F. 2d 996 (7th Cir. 1949).

Cross References:

Point 3: Sections 4-9-103 (3), 4-9-301 and 4-9-312 (5).

Definitional Cross References:

"Debtor". Section 4-9-105.

"Financing statement". Section 4-9-402.

"Secured party". Section 4-9-105.

"Security interest". Section 4-1-201.

COLORADO COMMENT

The Colorado legislative change to this section serves to ameliorate the harshness of this section in the official text. Without the Colorado amendment to subsection (3) the failure to timely file a continuation statement would cause a lapse in the effectiveness of the financing statement. The Colorado amendment provides that such a failure does not affect the validity of a secured party's security interest as against the debtor and further that the filing of a continuation statement after such a failure (but not later than two years after the time provided for filing) constitutes a valid continuation statement except as to any rights acquired during the time between the date the filing should have been made and the date actually filed.

As indicated in the last sentence of subsection (3), the statement does not actually lapse until expiration of the two-year period at which time it may be removed and destroyed pursuant to section 4-9-409.

"Appendix E"

SECTION SIXTY (11 U. S. C. § 96)

§ 60. *Preferred Creditors.* a. (1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

(2) For the purposes of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. A transfer of real property shall be deemed to have been made or suffered when it became so far perfected that no subsequent bona fide purchase from the debtor could create rights in such property superior to the rights of the transferee. If any transfer of real property is not so perfected against a bona fide purchase, or if any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of the petition.

(3) The provisions of paragraph (2) shall apply whether or not there are or were creditors who might have obtained such liens upon the property other than

real property transferred and whether or not there are or were persons who might have become bona fide purchasers of such real property.

(4) A lien obtainable by legal or equitable proceedings upon a simple contract within the meaning of paragraph (2) is a lien arising in ordinary course of such proceedings upon the entry or docketing of a judgment or decree, or upon attachment, garnishment, execution, or like process, whether before, upon, or after judgment or decree and whether before or upon levy. It does not include liens which under applicable law are given a special priority over other liens which are prior in time.

(5) A lien obtainable by legal or equitable proceedings could become superior to the rights of a transferee or a purchase could create rights superior to the rights of a transferee within the meaning of paragraph (2), if such consequences would follow only from the lien or purchase itself, or from such lien or purchase followed by any step wholly within the control of the respective lien holder or purchaser, with or without the aid of ministerial action by public officials. Such a lien could not, however, become so superior and such a purchase could not create such superior rights for the purposes of paragraph (2) through any acts subsequent to the obtaining of such a lien or subsequent to such a purchase which require the agreement or concurrence of any third party or which require any further judicial action, or ruling.

(6) The recognition of equitable liens where available means of perfecting legal liens have not been employed is hereby declared to be contrary to the policy of this section. If a transfer is for security if (A) applicable law requires a signed and delivered writing, or a delivery of possession, or a filing or recording, or other like overt action as a condition to its full validity against third persons other than a buyer in the ordinary course of trade claiming through or under the transferor and (B) such overt action has not been taken, and (C) such transfer results in the acquisition of only an equitable lien, then such transfer is not perfected within the meaning of paragraph (2). Notwithstanding the first sentence of paragraph (2), it shall not suffice to perfect a transfer which creates an equitable lien such as is described in the first sentence of paragraph (6), that it is made for a valuable consideration and that both parties intend to perfect it and that they take action sufficient to effect a transfer as against liens by legal or equitable proceedings on a simple contract: *Provided, however,* That where the debtor's own interest is only equitable, he can perfect a transfer thereof by any means appropriate fully to transfer an interest of that character: *And provided further,* That nothing in paragraph (6) shall be construed to be contrary to the provisions of paragraph (7).

(7) Any provision in this subdivision a to the contrary notwithstanding if the applicable law requires a transfer of property other than real property for or on account of a new and contemporaneous consideration to be perfected by recording, delivery, or otherwise, in order that no lien described in paragraph (2) could become superior to the rights of the transferee therein, or if the applicable law requires a transfer of real property for such a consideration to be so perfected in order that no bona fide purchase from the debtor could create rights in such property superior to the rights of the transferee, the

time of transfer shall be determined by the following rules:

I. Where (A) the applicable law specifies a stated period of time of not more than twenty-one days after the transfer within which recording, delivery, or some other act is required, and compliance therewith is had within such stated period of time; or where (B) the applicable law specifies no such stated period of time or where such stated period of time is more than twenty-one days, and compliance therewith is had within twenty-one days after the transfer, the transfer shall be deemed to be made or suffered at the time of the transfer.

II. Where compliance with the law applicable to the transfer is not had in accordance with the provisions of subparagraph I, the transfer shall be deemed to be made or suffered at the time of compliance therewith, and if such compliance is not had prior to the filing of the petition initiating a proceeding under this Act, such transfer shall be deemed to have been made or suffered immediately before the filing of such petition.

(8) If no such requirement of applicable law specified in paragraph (7) exists, a transfer wholly or in part, for or on account of a new and contemporaneous consideration shall, to the extent of such consideration and interest thereon and the other obligations of the transferor connected therewith, be deemed to be made or suffered at the time of the transfer. A transfer to secure a future loan, if such a loan is actually made, or a transfer which becomes security for a future loan, shall have the same effect as a transfer for or on account of a new and contemporaneous consideration.